**March 19, 2010**

# EMPOWERING THE FED?

The theme of this week's media cycle seems to be that the Fed can do no wrong. As a matter of fact, we should have a bigger, stronger Fed, right? The experts would disagree…

## WEDNESDAY – BERNANKE ON THE HILL

Federal Reserve Chairman Ben Bernanke will testify to the House Financial Services Committee about the link between Fed bank supervision and monetary policy on Wednesday.

Per Bloomberg News: Bernanke Will Tell Congress Bank Oversight Aids Monetary Policy…According to Bernanke, "the central bank is best qualified to oversee the largest financial institutions and should retain its oversight of smaller banks as well. The Fed's 'wide range of expertise' makes it 'uniquely suited to supervise large, complex financial organizations and to address both safety and soundness risks and risks to the stability of the financial system as a whole.'"

So…the Fed's expertise will guarantee safety and soundness in the event of a financial crisis…**Since early 2007, 254 banks have failed. Where was the Fed's expertise then?**

**Per AEI's Peter Wallison:** "The Fed had been regulating the largest banks and bank holding companies for over 50 years--among the very companies that would be considered systemically important--yet it failed to see the risks they were taking or the impending danger."

## MONDAY – SENATE MARKUP OF DODD BILL – PUTS CFPA IN THE FED

After negotiations with Senate Republicans deteriorated, Banking Chairman Chris Dodd announced his regulatory reform legislation by himself on Monday, which included an empowered Federal Reserve with the creation of the Consumer Financial Protection Agency.

Per Wall Street Journal: "**Federal Reserve Could Emerge With Enhanced Powers** … The Federal Reserve, battered by the public and politicians for months, emerged a winner in the latest Senate draft of legislation to remake the nation's financial regulatory system."

Amusingly enough, Financial Services Chairman **Barney Frank vehemently opposes the Dodd bill's housing of the CFPA in the Fed:** "I do not support housing the Consumer Financial Protection Agency in the Federal Reserve...My main objection to housing this critical function in the Federal Reserve has been the central bank's historical failure to implement consumer protection as a central part of its mission and role."

## ALSO…

**Tuesday, March 23, 2010**: House Financial Services Committee explores the GSE bailout with Secretary Geithner. On Christmas Eve 2009, the Treasury Department provided an unlimited bailout to Fannie Mae and Freddie Mac, and has yet to answer to the American taxpayers about it.

**REVIEW & OUTLOOK | MARCH 12, 2010**

THE WALL STREET JOURNAL

# A Financial Reform Reprieve
## No bill is better than one that is rushed and partisan.

Senate Banking Chairman Chris Dodd announced yesterday that bipartisan talks on financial reform have broken down, and he'll now introduce a Democratic bill on Monday. That strikes us as good news because it probably reduces the chances that a rushed and ill-thought reform will pass this year.

A year ago we were told a broad systemic reform had to pass quickly to rescue a teetering financial system, but that urgency has receded. Thanks to the Federal Reserve's extraordinarily low interest rates, banks have been able to make money riding the yield curve as they work off their bad loans.

Most banks have repaid their TARP money, and the Fed has been able to roll back its many new discount-window facilities. Even Citigroup CEO Vikram Pandit, whose bank is still a ward of the Treasury, managed to sound a bullish note this week. Credit markets continue to normalize, save for small business, which depend on small- and medium-sized banks that are still reluctant to lend to customers when they can make easier profits on the interest-rate carry trade. But this is not a problem legislation can solve.

Financial reform is still necessary, but not to meet some urgent distress. The point should to be to build a sturdier system that is more likely to avoid, and survive without a taxpayer rescue, the next mania and systemic panic. This demands much more careful thought and debate than the issue has received so far. Health care has dominated most of Washington's intellectual energy, such as it is, and the White House hasn't been to able to keep even its financial story straight.

First it focused on a major expansion of regulatory power for the same agencies that missed the last crisis. That reform has already passed the House but ran into trouble in the Senate. Then two months ago, after its Senate defeat in Massachusetts, the White House changed course and endorsed the "Volcker rule" to limit risky trading by banks. Treasury offered its first definition of the Volcker rule only two weeks ago, and most of the financial community is still trying to understand what it would mean in practice.

Meanwhile, a handful of Senators have been negotiating issues of enormous import behind closed doors and with little public influence. The proposal that has received the most debate—the White House plan for a new Consumer Financial Protection Agency—has thankfully been scaled back in these talks. But it remains a threat to further politicize bank lending decisions if it survives with any kind of real power.

Or take the regulation of credit derivatives, which Senators have been learning are more complicated than in normal media telling. Last month more than a hundred companies and trade associations sent a letter to Senate offices urging lawmakers to exempt derivatives customers from the heavy regulation passed by the House and contemplated in the Senate.

More Main Street than Wall Street, the signatories included Alcoa, Boeing, Caterpillar, Disney and Procter & Gamble. What they have in common is a need to manage financial risks, whether related to the value of the currency in a key export market, changes in interest rates, or perhaps the chance that a large customer could go bankrupt and leave behind some unpaid bills. Regulation crafted in haste could simply drive transactions offshore without reducing risks to the financial system.

Those who favor derivatives regulation also still haven't precisely defined the problem they wish to solve. Proponents talk of the need for transparency in the credit-default swap market so that regulators can monitor risks. But today regulators can already see essentially the entire market in the Trade Information Warehouse maintained by the Depository Trust and Clearing Corporation. A new clearinghouse might be useful unless it stifles trading or merely collects derivatives risk into another institution that is too big to fail.

We could go on, but the larger point is that Congress needs to get this reform done right, rather than quickly. By all accounts, Mr. Dodd's new and abrupt timetable for reform seems to have come after pressure from the White House and fellow Democrats. They want to get the voting underway before the brawl over health-care reconciliation poisons everything in the Senate.

By laying down a partisan marker, some Democrats also think they can gain electoral advantage in November if Republicans oppose it. We doubt it, considering the political dominance of health care and the economy. Republicans also know that they'll have much more influence over any reform next year, when they are likely to have more than 41 Senators.

Above all, we have learned from hard experience that when Congress acts in haste, it usually acts badly. Exhibit A is Sarbanes-Oxley. The Senate should take all the time it needs to avoid another such destructive reform.